74 877c 19 44pgs

No. 06-937

IN THE

Supreme Court of the United States

QUANTA COMPUTER, INC., QUANTA COMPUTER USA, INC., Q-LITY COMPUTER, INC., COMPAL ELECTRONICS, INC., BIZCOM ELECTRONICS, INC., SCEPTRE TECHNOLOGIES, INC., FIRST INTERNATIONAL COMPUTER, INC. AND FIRST INTERNATIONAL COMPUTER OF AMERICA, INC.,

Petitioners,

v.

LG ELECTRONICS, INC.,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

BRIEF OF *AMICUS CURIAE* INTERNATIONAL BUSINESS MACHINES CORPORATION IN SUPPORT OF PETITIONERS

DAVID J. KAPPOS
MARIAN UNDERWEISER
WILLIAM P. SKLADONY
IBM CORPORATION
One North Castle Drive
Armonk, NY 10504
(914) 765-4343

JOHN D. FLYNN
IBM CORPORATION
11501 Burnet Road
Austin, TX 78758
(512) 838-2753

TRACI L. LOVITT
(Counsel of Record)
OGNIAN V. SHENTOV
SARAH E. LIEBER
JONES DAY
222 East 41st Street
New York, NY 10017
(212) 326-3939

MICHAEL A. CARVIN
JONES DAY
51 Louisiana Ave., N.W.
Washington, DC 20001
(202) 879-3939

Counsel for Amicus Curiae

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

QUESTION PRESENTED

Whether the Federal Circuit erred in holding that respondent's patent rights were not exhausted by Intel Corporation's sale of a product to petitioners, where Intel was authorized under a license to manufacture and sell the product, and the petitioners did not expressly consent to any restrictions on their use of the product.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

TABLE OF AUTHORITIES v

INTEREST OF *AMICUS CURIAE* 1

STATEMENT 3

SUMMARY OF THE ARGUMENT 6

ARGUMENT 10

I. PATENTEES MUST OBTAIN EXPRESS AGREEMENT TO PRESERVE THEIR PATENT RIGHTS AGAINST THOSE WHO PURCHASE FROM AUTHORIZED SELLERS 10

A. This Court's Precedents Establish A Strong Exhaustion Doctrine That Applies With The Authorized Sale Of A Good With No Substantial Non-Infringing Use 10

B. An Exception To Exhaustion Exists Where Parties Agree To Limit The Purchaser's Rights Under The Patent Through Express Restrictions That Are Otherwise Valid Under Federal Law 14

TABLE OF CONTENTS
(continued)

Page

1. This Court has repeatedly recognized the patentee's ability to restrict licensees and their downstream purchasers through valid licensing restrictions 14

2. The Court's precedents compel the conclusion that patentees can restrict *purchasers*, but only through written agreements to which the purchasers expressly consent 18

C. A Rule Permitting Express Restrictions On Purchasers Fulfills The Goals Of Patent Law And The Exhaustion Doctrine 23

D. Applying These Principles Requires Reversal Of The Federal Circuit's Decision 26

E. The Federal Circuit's Decision Undermines The Doctrine Of Contributory Infringement 28

TABLE OF CONTENTS
(continued)

Page

II. A CONTRARY RULE THAT WOULD ENFORCE NONE OR ALL PURPORTED RESTRICTIONS ON THOSE WHO PURCHASE FROM AUTHORIZED SELLERS WOULD DISRUPT THE PATENT SYSTEM'S CAREFUL BALANCE 30

A. Adopting The Federal Circuit's Rule Would Have Significant And Immediate Detrimental Economic Impacts 30

B. An Alternative Rule Precluding Restrictions On Purchasers Would Over-Expand The Exhaustion Doctrine To The Detriment Of Innovation 32

CONCLUSION 35

TABLE OF AUTHORITIES

Page

Cases

Adams v. Burke,
84 U.S. 453 (1873) 10, 11, 20, 25
Aro Mfg. Co. v. Convertible Top Replacement Co., 377 U.S. 476 (1964) 29
Bandag, Inc. v. Al Bolser's Tire Stores, Inc.,
750 F.2d 903 (Fed. Cir. 1984) 34
Bloomer v. Millinger, 68 U.S. 340 (1863) .. 10, 14, 24
Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141 (1989) 7, 23
Brulotte v. Thys Co., 379 U.S. 29 (1964) 17
College Sav. Bank v. Fla. Prepaid Postsecondary Educ. Expense Bd.,
527 U.S. 666 (1999) 22
Cont'l T.V., Inc. v. G.T.E. Sylvania, Inc.,
433 U.S. 36 (1977) 17
Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co., Ltd., 535 U.S. 722 (2002) 25
Gen. Talking Pictures Corp. v. W. Elec. Co.,
305 U.S. 124 (1938) 8, 9, 14, 15, 16, 18, 22
Henry v. A.B. Dick Co., 224 U.S. 1 (1912), *overruled on other grounds by Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502, 517 (1917) 12
Hobbie v. Jennison, 149 U.S. 355 (1893) 11
Ill. Tool Works Inc. v. Indep. Ink, Inc.,
547 U.S. 28 (2006) 20, 28
Int'l Salt Co. v. United States,
332 U.S. 392 (1947) 16
Johnson v. Zerbst, 304 U.S. 458 (1938) 21
Keeler v. Standard Folding Bed Co.,
157 U.S. 659 (1895) 10, 19

TABLE OF AUTHORITIES
(continued)

Page

Markman v. Westview Instruments Inc., 517 U.S. 370 (1996) 25
Mentor H/S, Inc. v. Med. Device Alliance, Inc., 244 F.3d 1365 (Fed. Cir. 2001) 34
Mitchell v. Hawley, 83 U.S. (16 Wall.) 544 (1873) 8, 16, 22
Monsanto Co. v. McFarling, 488 F.3d 973 (Fed. Cir. 2007), *petition for cert. filed*, 76 U.S.L.W. 3081 (No. 07-241, Aug. 22, 2007) 34
Motion Picture Patents Co. v. Universal Film Mfg Co., 243 U.S. 502 (1917) 17, 20, 28
Patterson v. Illinois, 487 U.S. 285 (1988) 21
Providence Rubber Co. v. Goodyear, 76 U.S. (9 Wall.) 788 (1869) 14
Schneckloth v. Bustamonte, 412 U.S. 218 (1973) 21
Sony Corp. of Am. v. Universal Studios, Inc., 464 U.S. 417 (1984) 23
United States v. Gen. Elec. Co., 272 U.S. 476 (1926) 8, 15, 22
United States v. Line Material Co., 333 U.S. 287 (1948) 17
United States v. Univis Lens Co., 316 U.S. 241 (1942) 10, 12, 13
Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100 (1969) 17

TABLE OF AUTHORITIES
(continued)

Page

Statutes, Codes & Rules

35 U.S.C. § 154(a) 10
35 U.S.C. § 271(c) 29
U.C.C. § 2-702(2) 28
Sup. Ct. R. 37.3 1
Sup. Ct. R. 37.6 1

Miscellaneous

Mark A. Lemley, *Ten Things to do About Patent Holdup of Standards (And One Not To)*, 48 B.C. L. REV. 149 (2007) 31
Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 U. TEX. L. REV. 1991 (2007) 31
Roger M. Milgrim, MILGRIM ON LICENSING (2007) 11, 12, 17, 19, 33
John W. Schlicher, PATENT LAW, LEGAL AND ECONOMIC PRINCIPLES (2d ed. 2006) 18
William P. Skladony, *Commentary on Select Patent Exhaustion Principles In Light of The LG Electronics Cases*, 47 IDEA 235 (2007) 12
U.S. Dep't of Justice and Federal Trade Comm'n, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY 5 (1995), *reprinted in* Trade Reg. Rep. (CCH) ¶ 13,132 (Apr. 6, 1995) 33
U.S. Patent & Trademark Office, PATENTING BY ORGANIZATIONS 2006 (March 2007) 1

TABLE OF AUTHORITIES
(continued)

Page

Katherine E. White, *A Rule for Determining When Patent Misuse Should Be Applied*, 11 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 671 (2001) 16, 19

International Business Machines Corporation ("IBM") respectfully submits this brief pursuant to Supreme Court Rule 37.3 in support of petitioners.[1] IBM urges the Court to apply its longstanding precedents and reverse the judgment of the United States Court of Appeals for the Federal Circuit.

INTEREST OF *AMICUS CURIAE*

IBM has a strong interest in an evenhanded and fair interpretation of patent law, as it is both a patentee and a manufacturer. IBM is well known as a strong proponent of the U.S. patent system. It has received tens of thousands of patents, has been awarded more United States patents than any other assignee for fourteen consecutive years,[2] and earns about $1 billion every year from licensing its

---

[1] Pursuant to Supreme Court Rule 37.6, IBM states that no counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amicus curiae*, its members, or its counsel made a monetary contribution to its preparation or submission. In addition, all parties have consented to the filing of this *amicus* brief, and their consent letters are on file with the Clerk's Office.

[2] For example, the United States Patent and Trademark Office reported that in 2006, IBM received 3,621 patents, which is over 1,170 more United States patents than any other company. *See* United States Patent & Trademark Office, PATENTING BY ORGANIZATIONS 2006 (March 2007), *available at* http://www.uspto.gov/go/taf/topo_06.pdf (last visited Nov. 9, 2007).

intellectual property portfolio. But, IBM also earns over $90 billion from sales of information technology equipment and services annually and thus defends against many adverse patent accusations and lawsuits each year.

With respect to the specific question presented, IBM is unusually well-positioned to provide unbiased commentary on how the rule of exhaustion should justly limit patentees' exclusive rights without harming innovation or the public interest. IBM has no direct stake in the particular dispute between petitioners and respondent, because it is licensed to the patents at issue in this case. In addition, IBM is not inclined to favor licensees and purchasers over patent owners, or vice versa. As one of the most successful licensors of patented technology in the world, IBM relies on its ability to enforce its patents in order to advance its business interests. But, as a large corporation focused on offering innovative products and services in a broad range of fields, IBM is frequently forced to defend against charges of infringement.

IBM is also well aware of the exhaustion issues that arise not only in the information technology sector but also in a broad spectrum of different industries, all of which would be impacted by changes to the doctrine. IBM's business interests encompass a diverse range of industries and fields that enable, and are enabled by, information technology, including software and computer technology, electrical engineering, life sciences, physical and organic chemistry, business consulting, computer services, engineering services, and the mechanical arts.

IBM thus has a strong interest in maintaining a fair patent system, and in fashioning clear and evenhanded rules of exhaustion that promote innovation in all industries, while properly balancing the interests of the patent owner, the accused infringer, and the public, rather than favoring any particular party.

STATEMENT

1. Respondent owns a portfolio of U.S. and foreign patents relating to personal computers, including patents claiming systems and methods to increase the bandwidth efficiency of computer systems. Pet. App. 2a. Intel Corporation ("Intel") is authorized by respondent to manufacture and sell microprocessors and chipsets that otherwise would infringe respondent's patents. Pet. App. 2a-3a. Petitioners purchase chipsets and microprocessors from Intel and combine them with other equipment in accordance with exact specifications from Intel to make computers. *See id.*; Pet. 3. By necessity, microprocessors and chipsets must be combined with these other computer components to be of any use. *See* Opp. 9.

2. Two agreements between respondent and Intel govern Intel's ability to manufacture and sell the chipsets and microprocessors at issue here.

The first is a patent license (the "License Agreement") by which Intel agreed to pay respondent for the unrestricted right to "make, use, sell (directly or indirectly), offer to sell, import and otherwise dispose of" microprocessors and chipsets. Pet. App. 33a (citation omitted). The License Agreement also provides that "[n]otwithstanding anything to the contrary contained in this Agreement, the parties

agree that nothing herein shall in any way limit or alter the effect of patent exhaustion that would otherwise apply when a party hereto sells any of [the licensed products]." Pet. at 3-4.

The second relevant agreement is the "Master Agreement." *Id.*; Opp. 3. It incorporates the License Agreement by reference and provides: "' [respondent] and Intel intend and acknowledge that [respondent's] grant of a license to Intel for Integrated Circuits . . . shall not create any express or implied license under [respondent's] patents to computer system makers [such as petitioners] that combine Intel Integrated Circuits with other non-Intel components to manufacture motherboards, computer subsystems, and desktop, notebook and server computers'." Opp. 6 (quoting Master Agreement § 2). The Master Agreement provides that Intel will send a notice to its customers stating, in pertinent part, that Intel has a "broad patent license" from respondent that "ensures that any Intel product that you purchase is licensed by [respondent] and thus does not infringe any patent held by [respondent]." Opp. 7 (internal quotation marks omitted). The notice further states: "Please note however that while the patent license that [respondent] granted to Intel covers Intel's products, it does not extend, expressly or by implication, to any product that you may make by combining an Intel product with any non-Intel product." *Id.* (citation omitted).

3. It is undisputed that petitioners received the required notice from Intel before purchasing some of the components at issue. *See id.*; Reply Br. 9. Petitioners thereafter simply combined the chips with other non-Intel products pursuant to Intel's

exact specifications. Pet. 3. Petitioner's computers were then sold in the U.S. and around the world.

4. Between late 2000 and spring 2001, respondent brought separate suits against petitioners, alleging that they (and another company with whom respondent has since settled) had infringed six of respondent's patents. Specifically, respondent claimed that, while Intel's manufacture of the infringing chipsets was authorized under the License Agreement, petitioners' combination of those chipsets with non-Intel products was not. *See* Pet. App. 3a. On August 20, 2002, the district court granted petitioners' motion for partial summary judgment of non-infringement on the ground that respondent's unrestricted license to Intel and Intel's subsequent sale of the chipsets and microprocessors to petitioners exhausted respondent's rights to recover royalties with respect to those items. Pet. App. 32a-45a.

5. In the proceedings below, the Federal Circuit reversed. In its view, exhaustion occurs only where there is an "unconditional" sale such that "the patentee has bargained for, and received, an amount equal to the full value of the goods." Pet. App. 5a (internal quotation marks and citation omitted). But when a sale is "conditional," the Federal Circuit reasoned, "the parties negotiat[e] a price that reflects only the value" of those limited rights and thus the patent rights might not be fully exhausted. *Id.*

The Federal Circuit concluded that no exhaustion had occurred under this rule because the Master Agreement "expressly disclaims [Intel's right to] grant[] a license allowing computer system manufacturers to combine Intel's licensed parts with

other non-Intel components. Moreover, this conditional agreement required Intel to notify its customers of the limited scope of the license, which it did. Although Intel was free to sell its microprocessors and chipsets, those sales were conditional, and Intel's customers were expressly prohibited from infringing [respondent's] combination patents." Pet. App. 6a. The unilateral notice was binding on petitioners and conditioned the sale, in the Federal Circuit's view, due to New York Uniform Commercial Code § 2-202, "the battle of the forms" provision, which provides that a contract may be "supplemented by consistent additional terms unless the writing is intended to be complete and exclusive." *Id.*

SUMMARY OF THE ARGUMENT

This case presents a unique challenge to maintaining balance and fairness in the patent exhaustion doctrine because the facts are so extreme. Respondent expressly authorized Intel to manufacture and sell chipsets and microprocessors that had only one purpose, to be combined with other components and made into computers. Respondent required only that Intel notify its customers—petitioners—that they were not authorized to combine the chipsets and microprocessors with non-Intel products. Intel gave this unilateral notice to petitioners but also provided detailed and exact specifications on how to make the infringing combination.

In light of these unique facts, it is tempting to reach an extreme result and conclude, like the Federal Circuit, that *any* condition on a sale, including a unilateral notice to a purchaser, can overcome exhaustion or conclude, like other *amici* are

bound to suggest, that restrictions on downstream purchasers are *never* valid where a sale is authorized and the sold article has no substantial noninfringing use.

But, patent law and policy should not be defined to operate so starkly. Indeed, any pronouncements in the patent field must take into account the delicate balance between promoting innovation and promoting competition that is necessary for a functional patent system. *See Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 156 (1989). In the exhaustion context, this balance means that the point at which patent rights terminate must be fairly and clearly defined. An overly-broad exhaustion doctrine, one that terminates patent rights too easily, would undercut the incentive to innovate. But an overly-narrow doctrine, one that entitles patentees to recover multiple royalties for the same infringement, would allow patentees to over-leverage their patents to the detriment of the public and undercut the incentive for follow-on innovation and commercialization. And, a doctrine that requires judicial resolution to determine whether exhaustion has occurred would fail to provide the certainty necessary for commerce to function efficiently.

As IBM explains, this Court's jurisprudence and the policies underlying exhaustion require a rule that lies between the extremes: while an authorized sale of a product with no substantial non-infringing use exhausts the patent right, the licensee or downstream purchaser can expressly agree to restrictions that would overcome exhaustion with respect to restricted activities, so long as those restrictions do not violate the federal antitrust laws,

misuse or expand the patent right, or otherwise constitute an invalid restraint. As this Court has recognized, exhaustion is a strong doctrine that terminates the patentee's rights via an authorized sale of a patented article with no substantial non-infringing use. But, just as a patentee can control its own sales of a patented article, it can restrict the authority of licensees through effective licensing agreements. It can also restrict the rights of purchasers through express agreements. Because purchasers are legally entitled to rely on the exhaustion effect of an authorized sale, however, the latter restrictions should be enforceable only if the purchaser expressly consents and agrees to them. Any alternative rule would upset the settled commercial expectations of those who purchase patented articles from patentees or their authorized sellers.

IBM's interpretation of the enforceability of restrictions on purchasers is a direct outgrowth of this Court's jurisprudence. The Court has repeatedly recognized that patentees may issue restrictive licenses limiting a licensee's authority and that a licensee's sale or other action outside the scope of its restricted license constitutes infringement, exposing the licensee and everyone downstream to strict liability for infringement. *See Mitchell v. Hawley*, 83 U.S. (16 Wall.) 544, 548 (1873); *United States v. Gen. Elec. Co.*, 272 U.S. 476, 490 (1926). Thus, the Court has held that a patentee can avoid exhaustion and restrict licensees and downstream purchasers by defining *unauthorized* conduct in a licensing agreement. *See Gen. Talking Pictures Corp. v. W. Elec. Co.*, 305 U.S. 124, 126 (1938).

The same reasoning applies in the context of an *authorized* sale by a licensee or the patentee. Just as a patentee can place restrictions on a licensee selling patented products, it can place restrictions on a purchaser of such products through express agreements with the purchaser. Where those restrictions limit the purchaser's rights under the patent, they give rise to a claim of infringement liability for activities by the purchaser outside the restrictions. *See id.* Because such restrictions are contrary to the normal operation of patent exhaustion and the expectations of the purchaser, however, they must be the result of an agreement to which the purchaser has expressly consented. Otherwise, the restrictions are insufficiently clear to demonstrate that the bargained-for sale of the patented product was for less than the full rights under the patent.

IBM's interpretation of exhaustion is not only consistent with this Court's jurisprudence but necessary to effect the basic balance underlying the patent system. The fundamental point of exhaustion is that the patentee can be compensated only once for the same infringement; it gets one bite at the apple. But, this Court has long permitted the patentee to divide that bite into smaller nibbles. So long as a licensee or a purchaser expressly agrees that it is restricted to make, use or sell only the smaller nibble, enforcing the restriction is fair, allows the patentee to receive only partial compensation commensurate with the restricted rights granted, and promotes competition by allowing the patentee to offer an array of different rights under the patent at varying valuations. The purchaser benefits from this regime,

as it can obtain at a lower price only the rights it needs, certain of the rights it has purchased.

ARGUMENT

I. PATENTEES MUST OBTAIN EXPRESS AGREEMENT TO PRESERVE THEIR PATENT RIGHTS AGAINST THOSE WHO PURCHASE FROM AUTHORIZED SELLERS.

A. This Court's Precedents Establish A Strong Exhaustion Doctrine That Applies With The Authorized Sale Of A Good With No Substantial Non-Infringing Use.

It is well established that patent law grants to the patent holder the "right to exclude others from making, using, offering for sale, or selling the invention." 35 U.S.C. § 154(a). But, it is also well established that "when the patentee, or the person having his rights, sells a machine or instrument whose sole value is in its use, he receives the consideration for its use and he parts with the right to restrict that use. The article, in the language of the court, passes without the limit of the monopoly." *Adams v. Burke*, 84 U.S. 453, 456 (1873); *see United States v. Univis Lens Co.*, 316 U.S. 241, 249-50 (1942); *Keeler v. Standard Folding Bed Co.*, 157 U.S. 659, 664 (1895); *Bloomer v. Millinger*, 68 U.S. 340, 351-52 (1863). This rule of patent exhaustion was stated by the Court over one hundred years ago as follows:

> [T]he patentee or his assignee having in the act of sale received all the royalty or consideration which he claims for the use of his invention in that particular

> machine or instrument, it is open to the use of the purchaser without further restriction on account of the monopoly of the patentees.

Adams v. Burke, 84 U.S. at 456; *see also* 1 Roger M. Milgrim, MILGRIM ON LICENSING § 2.30, at 2-64 n.161 (2007) ("[W]hen an authorized licensee exercises the licensed right to make, use and sell a patented product the patentee's patent rights in the product are exhausted upon that sale.").

Thus, in *Adams v. Burke*, the Court affirmed the dismissal of an infringement action against a downstream purchaser in a case involving a patent on improvements to coffin lids where the patentee had authorized the manufacture and sale of infringing coffins but only within a ten-mile radius of Boston. 84 U.S. at 456-57. The infringing coffin was sold, without restriction, within this geographic area but then used by the purchaser outside of the restricted area. *Id.* The Court reasoned that although the right "to manufacture, to sell, and to use these coffin-lids was limited to the circle of ten miles around Boston, . . . a purchaser . . . of a single coffin acquired the right to use that coffin for the purpose for which all coffins are used. That so far as the use of it was concerned, the patentee had received his consideration, and it was no longer within the monopoly of the patent." *Id.* at 456; *see also Hobbie v. Jennison*, 149 U.S. 355, 363 (1893) (holding licensee was not a contributory infringer in selling an item to one who made an infringing combination, "because he had a right, under the patent, to make, use, and vend the patented article in the state of Michigan, and the article was lawfully made and sold

there. The pipes in question were not sold by the Hartford Steam Company in Connecticut, but were merely used there, and necessarily perished in the using").

Similarly, in *Univis Lens*, a case involving patents on multifocal lenses, the Court invalidated under the Sherman Act a price maintenance program effected through a patentee's licensing program with wholesalers and finishing retailers that would purchase lens blanks from the patentee and grind them into a prescription. In doing so, the Court reasoned, "where one has sold an uncompleted article which, because it embodies the essential features of his patented invention, is within the protection of his patent, and has destined the article to be finished by the purchaser in conformity to the patent, he has sold his invention so far as it is or may be embodied in that particular article." 316 U.S. at 250-51; *see also* William P. Skladony, *Commentary on Select Patent Exhaustion Principles In Light of The LG Electronics Cases*, 47 IDEA 235, 236-40 (2007) (discussing this Court's exhaustion jurisprudence).

Because an article that "embodies the essential features" of a patented invention generally has no substantial alternative use that would be non-infringing, the rule of exhaustion has alternatively been described as "where a patented apparatus or product has no use other than an infringing use, its sale to a third party . . . exhausts the patent." MILGRIM, *supra*, § 2.30, at 2-64 n.161; *see Henry v. A.B. Dick Co.*, 224 U.S. 1, 48 (1912), *overruled on other grounds by Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502, 517 (1917) ("[A] sale of an article which, though adapted to an

infringing use, is also adapted to other and lawful uses, is not enough to make the seller a contributory infringer. Such a rule would block the wheels of commerce."). Although the essential features doctrine and the concept of substantial non-infringing use are distinct, the alternative descriptions of the exhaustion test are, for all intents and purposes, identical in effect.

The upshot of these precedents is a strong exhaustion doctrine—one that applies on the authorized sale of a patented item with no substantial non-infringing use. [3]

---

[3] In the proceedings below, the Federal Circuit concluded that an authorized sale does not exhaust "method" patents—patents that disclose and claim a process, whether a technical process or a method of doing business. *See* Pet. App. 6a (holding that "the sale of a device does not exhaust a patentee's rights in its method claims"). In IBM's view, this conclusion is clearly contrary to the Court's decision in *Univis Lens*, in which the patent found to be exhausted by an authorized sale was a method patent. *See* 316 U.S. at 246-47 (describing the patents at issue). A contrary rule, moreover, would effectively eliminate the exhaustion doctrine because patentees would simply include method or process claims to avoid exhaustion. In the information technology context in particular, a contrary rule would harm the public interest, since it is often the unsuspecting end user or consumer who is practicing a method claim by simply using a computer.

B. An Exception To Exhaustion Exists Where Parties Agree To Limit The Purchaser's Rights Under The Patent Through Express Restrictions That Are Otherwise Valid Under Federal Law.

While the Court has recognized a strong exhaustion doctrine, it has also recognized, for over a century, an exception to exhaustion where there is an express agreement limiting the licensee's or purchaser's rights under a patent. In short, the Court has recognized the patentee's ability to grant less than the full patent right, and a licensee's or purchaser's freedom to contract for the purchase of a lesser right at a lower price.

1. This Court has repeatedly recognized the patentee's ability to restrict licensees and their downstream purchasers through valid licensing restrictions.

The law permits a patentee to "carve out of his entire monopoly such fractional interest therein, either as to absolute right, or as to territorial extent, or as to duration of right, as he may see fit" and transfer only that limited right. *Bloomer*, 68 U.S. at 346; *see also Providence Rubber Co. v. Goodyear*, 76 U.S. (9 Wall.) 788, 799-800 (1869) (upholding the validity of a restricted license). Indeed, as this Court has recognized, "[t]he practice of granting licenses for a restricted use is an old one. So far as appears, its legality has never been questioned." *Gen. Talking Pictures Corp.*, 305 U.S. at 127 (internal citations omitted).

Consistent with this Court's recognition of the patentee's ability to grant licenses of limited scope,

the Court has held that exhaustion does *not* apply when a licensee makes an unauthorized sale outside the scope of its patent license. Thus, in *United States v. General Electric Company*, the Court held that the owner of patents relating to tungsten incandescent lamps could validly impose conditions in a licensing agreement that restricted the licensee's ability to sell electric lamps covered by the patent. *See* 272 U.S. at 489. The Court reasoned that, while it was well settled that exhaustion occurs "where a patentee makes the patented article, and sells it" without restriction, "the question is a different one which arises when we consider what a patentee who grants a license to one to make and vend the patented article may do in limiting the licensee in the exercise of the right to sell." *Id.* at 489-90. In the licensing context, the Court continued, "[t]he patentee may make and grant a license to another to make and use the patented articles but withhold his right to sell them. The licensee in such a case acquires an interest in the articles made. He owns the material of them and may use them. But if he sells them he infringes the right of the patentee, and may be held for damages and enjoined." *Id.* at 490.

Similarly, in *General Talking Pictures Corp.*, 305 U.S. 124, the Court upheld an infringement action against a licensee and downstream purchaser where the licensee was authorized to sell the patented article (amplifiers) in only a certain "field of use" (for radio reception) but sold the patented article for a different use (for theater motion-picture machines). *Id.* at 125-26. The Court reasoned that the validity and legality of the restrictive license was "clear." *Id.* at 127. "As the restriction was legal and the amplifiers were made and sold outside the scope of

the license, the effect is precisely the same as if no license whatsoever had been granted to [the licensee]." *Id.*

Indeed, this Court has made clear that where a licensee has made an unauthorized sale outside the scope of its license, the downstream purchaser infringes even if it lacks notice that the licensee is acting in an unauthorized manner. The reason, in the Court's view, is that one "who buys goods from one not the owner, and who does not lawfully represent the owner, however innocent [he] may be, obtain[s] no property whatever in the goods, as no one can convey in such a case any better title than he owns, unless the sale is made in market overt, or under circumstances which show that the seller lawfully represented the owner." *Mitchell*, 83 U.S. at 550. "Notice to the purchaser in such a case is not required, as the law imposes the risk upon the purchaser, as against the real owner, whether the title of the seller is such that he can make a valid conveyance." *Id.* Any other rule would defeat the well-settled principle that "[r]estrictions on patent rights travel downstream." Katherine E. White, *A Rule for Determining When Patent Misuse Should Be Applied*, 11 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 671, 693 (2001).

To be sure, the Court has recognized numerous limits on the ability of the patentee to impose downstream restrictions. Most obvious, the patentee cannot impose any restrictions that would otherwise violate the federal antitrust laws. *See Int'l Salt Co. v. United States*, 332 U.S. 392 (1947) (invalidating restriction that would have violated anti-tying provisions of Sherman and Clayton Acts); *United*

States v. Line Material Co., 333 U.S. 287, 304 (1948) (holding that notwithstanding *General Electric*, it is unlawful to use patents "as a peg upon which to attach contracts with former or prospective competitors, touching business relations other than the making and vending of patented devices").

In addition, the patentee cannot misuse or expand its patent right. "The patent law simply protects [the patentee] in the monopoly of that which he has invented and described in the claims of his patent." *Motion Picture Patents Co. v. Universal Film Mf'g Co.*, 243 U.S. 502, 510 (1917). Thus, the Court has held that the patentee cannot lawfully negotiate to obtain "royalty payments beyond the life of the patent," because doing so "is analogous to an effort to enlarge the monopoly of the patent." *Brulotte v. Thys Co.*, 379 U.S. 29, 33 (1964); *see also Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 136 (1969) (observing that the patentee cannot "extend the monopoly of his patent to derive a benefit not attributable to use of the patent's teachings").

Apart from these limits imposed by antitrust and patent misuse principles, the authority of the patentee to impose downstream restrictions, such as field-of-use, geographical, and other such restrictions, through effective licensing is well established. *See, e.g.*, MILGRIM, *supra*, § 2.31; *see also Cont'l T.V., Inc. v. G.T.E. Sylvania, Inc.*, 433 U.S. 36 (1977) (holding that non-price, vertical resale restrictions are *not* per se violations of the Sherman Act and are judged under the rule of reason).

2. The Court's precedents compel the conclusion that patentees can restrict *purchasers*, but only through written agreements to which the purchasers expressly consent.

While *General Talking Pictures* arose in the context of the validity and downstream impact of restrictions in licensing agreements, it supports the principle that a patentee can validly impose restrictions on a purchaser's ability to use a patented article. That is, in *General Talking Pictures*, the Court held that field-of-use-restrictions are lawful and valid. And "[i]f the purchaser in *General Talking Pictures* is liable for infringement when he sells outside of the known limited field of the authority of his supplier, it would seem logical that an identical express license restriction on his rights made at the time of sale would be lawful." *See* 2 John W. Schlicher, PATENT LAW, LEGAL AND ECONOMIC PRINCIPLES § 8:61 (2d ed. 2006).

In other words, had the licensee in *General Talking Pictures* complied with the terms of the licensing agreement, the purchasers would have had only the limited right to use the amplifiers in radios; their use in a different field would have exceeded the scope of the right the licensee had to sell and thus the right the purchaser had to purchase. The decision thereby necessarily approved of the patentee's ability to impose field-of-use restrictions on purchasers. For this reason, treatises in the patent licensing arena warn that "not every purchase provides a free ticket to future use because certain countervailing doctrines may defeat exhaustion: notably, whether there are

still any valid field-of-use restrictions." MILGRIM, *supra*, § 2.31, at 2-66-2-67; *see also id.* §§ 2.31-2.36 (describing the various permissible restrictions).

While this Court has not directly considered the mechanisms by which a patentee can restrict purchasers involved in an *authorized* sale—a sale by the patentee or a licensee acting within the scope of its license—numerous of the Court's precedents, read as a body of law, make clear that field-of-use, geographical and other restrictions on such purchasers (i) are enforceable when the restrictions are contained in a written agreement to which the purchaser has expressly consented, and (ii) can be enforced against only those bound by the contractual agreement. In other words, the restrictions do not automatically carry downstream with an authorized sale. *See* White, *supra*, at 694. ("[A] patent owner may place conditions on a sale of a patented product through contract, but such restrictions should apply only to those in privity of contract. Generally, only those who are in privity of contract, with the exception of intended beneficiaries, may sue on a contract.") (footnotes omitted).

Specifically, the Court has recognized that the patentee can limit the purchaser "by special contracts brought home to the purchasers." *Keeler*, 157 U.S. at 666. Although the issue was not before the Court, it observed that "[i]t [was] obvious that such a question would arise as a question of contract, and not as one under the inherent meaning and effect of the patent laws." *Id.* Thus, a purchaser can contractually agree to restrictions on its rights under a patent that it would normally enjoy by virtue of an authorized sale. Having contractually agreed to restrictions that

modify the normal operation of exhaustion, the purchaser would be liable for infringement if it used the article outside the scope of its restricted right. Because the patentee's right to sue for infringement in this instance arises only as a result of a contract, however, the restriction would not travel downstream upon a subsequent authorized sale absent a further express agreement restricting the subsequent purchaser.

Where a patentee has attempted to control a direct purchaser engaged in an authorized sale through something less than an expressly agreed-to contractual arrangement, for example through a unilateral notice affixed to the side of the patented article, the attempt has been held invalid. *See, e.g.*, *Motion Picture Patents Co.*, 243 U.S. at 518-19. The Court has held that there is "no support in the patent laws for the proposition that a patentee may prescribe by notice attached to a patented machine the conditions of its use and the supplies which must be used in the operation of it, under pain of infringement of the patent," where there has been an authorized sale. *Ill. Tool Works Inc. v. Indep. Ink, Inc.*, 547 U.S. 28, 38 (2006) (internal quotation marks omitted).

In addition, the Court has previously invalidated *implied* restrictions on purchasers engaged in an *authorized* sale. It has held that, after an authorized sale, "there is no restriction on [the infringing article's] use to be *implied* for the benefit of the patentee or his assignees or licensees." *Adams v. Burke*, 84 U.S. at 457 (emphasis added). This rule makes sense given that any restriction on such a purchaser must overcome the strong presumption

that an authorized sale of a patented article exhausts the patent rights with respect to the purchaser. This strong presumption, moreover, is underpinned by common sense—in the absence of an agreement, a purchaser should not expect a charge of infringement from a patentee who has authorized the sale of a patented article. Indeed, given the need to preserve the settled expectations of buyers in the ordinary course of trade, it is axiomatic that any restriction purporting to limit the exhaustion doctrine's operation must be explicit and the burden to procure explicit restrictions must rest with the patentee.

Allowing a purchaser to waive exhaustion through express agreement is consistent with the Court's general jurisprudence concerning the waiver of federal rights. This Court has recognized that federal rights (even constitutional rights) are waivable, but an effective waiver requires the "intentional relinquishment or abandonment of a known right or privilege." *Johnson v. Zerbst*, 304 U.S. 458, 464 (1938); *see also Schneckloth v. Bustamonte*, 412 U.S. 218, 228 (1973), (observing that such waivers cannot be "coerced, by explicit or implicit means, by implied threat or covert force). Where the waiver is knowing and voluntary, moreover, the Court has enforced waivers of even the most fundamental constitutional rights. *See, e.g.*, *Patterson v. Illinois*, 487 U.S. 285, 292-93 (1988) (upholding validity of a waiver of the right to counsel). Applying those principles here means that where a patentee seeks to restrict the rights of a purchaser, the purchaser's waiver of rights under patent law should be express, knowing and voluntary, and should be enforced where those conditions are satisfied. *See Coll. Sav. Bank v. Fla.*

Prepaid Postsecondary Educ. Expense Bd., 527 U.S. 666, 682 (1999) (observing that waivers of state and federal sovereign immunity are "not [to be] implied" but that express and voluntary waivers are valid and enforceable).

The combined impact of the Court's precedents is thus that the patentee can limit the rights of purchasers in two ways. *First*, a patentee can expressly limit the authority of a *licensee* to manufacture, sell or use an article covered by the patent, such that an "unauthorized sale" to a downstream purchaser would fail to exhaust the patent right and give rise to a cause of action for infringement against either the licensee or the purchaser. This is precisely the result in *General Talking Pictures*, 305 U.S. at 127, *General Electric*, 272 U.S. at 489-90, and *Mitchell*, 83 U.S. at 550.

Second, the patentee and purchaser can expressly agree to limit the rights that the purchaser would normally have as a result of an authorized sale, such that a violation of those limitations would be actionable in an infringement action. However, the limitations would not flow downstream with a subsequent authorized sale absent an additional express agreement with a downstream purchaser. The written contractual arrangement can be with the patentee directly, for example where the patentee acts as seller, or through a licensee if the patentee requires such a contract in the licensing agreement with the licensee. In all instances, however, the restrictions must be valid under the federal antitrust laws and cannot expand or misuse the patent right. *See supra* at 16-17.

C. A Rule Permitting Express Restrictions On Purchasers Fulfills The Goals Of Patent Law And The Exhaustion Doctrine.

A strong exhaustion doctrine, but one that recognizes the patentee's ability to limit the authority of licensees through licensing agreements and restrict the rights of purchasers through express agreements where those restrictions are otherwise valid under federal law is not only the direct outgrowth of this Court's jurisprudence but also necessary to realize the policies and purposes of patent law.

First, a rule that preserves a strong exhaustion doctrine but permits parties to agree to restrictions within the scope of the patent grant that otherwise satisfy antitrust and patent misuse requirements (*see supra* pp. 16-17) strikes an appropriate balance.

One of the basic policies of patent law is to "balance between the need to encourage innovation and the [need to avoid] monopolies which stifle competition." *Bonito Boats*, 489 U.S. at 146. Congress sought to "defin[e] the scope of the limited monopoly that should be granted to authors or to inventors in order to give the public appropriate access to their work . . . [and reach] a difficult balance between the interests of authors and inventors in the control and exploitation of their writings and discoveries on the one hand, and society's competing interest in the free flow of ideas, information, and commerce on the other hand." *Sony Corp. of Am. v. Universal Studios, Inc.*, 464 U.S. 417, 429 (1984).

The exhaustion doctrine is a powerful tool for achieving this balance, because it prevents the recovery of multiple royalties for the same infringement. Exhaustion permits the patentee "but one royalty for a patented machine, and consequently when . . . consideration has been paid to him for the [patented] right, he has then to that extent parted with his monopoly, and ceased to have any interest whatever in the machine so sold or so authorized to be constructed and operated." *Bloomer*, 68 U.S. at 351-52.

Permitting patentees to enforce otherwise valid restrictions through licenses and express agreements with purchasers serves these purposes. Such a rule would prevent the patentee from extracting multiple royalties for the same infringement, because all parties with an economic interest under the patent will have a seat at the negotiating table, and all parties will negotiate clear restrictions on the activities covered by the patent where such restrictions are the product of mutual agreement. That is, when the licensee or purchaser acting in a commercially reasonable manner clearly agrees to a grant of less than full rights under the patent, they will compensate the patentee accordingly. Absent an express restriction, the patentee will be legally held to have obtained a full royalty from the licensee or a purchaser for a fully authorized sale.

Second, a vigorous exhaustion doctrine that is excepted only where there are express restrictions on the rights under a patent will achieve much needed clarity in the law. As this Court has recognized, clarity is necessary to maintain the patent system's effectiveness. "A patent holder should know what he

owns, and the public should know what he does not" to satisfy "the delicate balance the law attempts to maintain between inventors, who rely on the promise of the law to bring the invention forth, and the public, which should be encouraged to pursue innovations, creations, and new ideas beyond the inventor's exclusive rights." *Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co., Ltd.*, 535 U.S. 722, 731 (2002). The importance of providing notice to the public of the scope of patent rights cannot be overstated:

> [T]he limits of a patent must be known for the protection of the patentee, the encouragement of the inventive genius of others and the assurance that the subject of the patent will be dedicated ultimately to the public. Otherwise, a zone of uncertainty which enterprise and experimentation may enter only at the risk of infringement claims would discourage invention only a little less than unequivocal foreclosure of the field.

Markman v. Westview Instruments Inc., 517 U.S. 370, 390 (1996) (internal quotation marks omitted). This is particularly true in the exhaustion context, because exhaustion defines the legal termination point of the patentee's exclusionary rights. *See Adams v. Burke*, 84 U.S. at 456. Thus, the circumstances by which a patentee can avoid this termination must be unmistakably clear to it and to purchasers.

Requiring an express agreement to overcome the normal operation of exhaustion would provide this clarity. A licensee that disregards clear restrictions

on its authority has long been understood to assume the risk of infringement because it has consented to those restrictions. Similarly, a purchaser will know whether it is subject to restrictions because it will have to expressly agree to the restrictions by written contract.

D. Applying These Principles Requires Reversal Of The Federal Circuit's Decision.

Applying these principles here requires reversal of the Federal Circuit's decision, because Intel's sales of the chipsets and microprocessors—articles with no substantial non-infringing uses—were authorized under the License Agreement, and petitioners did not expressly agree to restrictions on their use of these articles.

With respect to Intel's authority under the License Agreement, there is no dispute that its manufacture and sale of the chipsets and microprocessors were authorized. The License Agreement expressly authorizes Intel to "make, use, sell (directly or indirectly), offer to sell, import and otherwise dispose of all Intel Licensed Products" without restriction. Pet. App. 33a (internal quotation marks omitted). The Master Agreement further recognizes Intel's authority to sell the chipsets and microprocessors by allowing Intel to represent to potential purchasers that it has a "broad patent license" from respondent that "ensures that any Intel product that you purchase is licensed by [respondent] and thus does not infringe any patent held by [respondent]." Opp. 7 (internal quotation marks omitted). To be sure, the Master Agreement requires Intel to notify downstream purchasers of respondent's contention

that Intel's authority under the License Agreement "does not extend, expressly or by implication, to any product that you may make by combining an Intel product with any non-Intel product." *Id.* (internal quotation marks omitted). It is undisputed that Intel satisfied this requirement. *See id.*; Reply Br. 9. In addition, it is clear that the chipsets and microprocessors had only one substantial use—to be combined with other products and made into a computer. Opp. 9; Pet. App. 46a. Indeed, Intel provided purchasers with exact specifications instructing them how to make this combination. Pet. 3.

Having made an authorized sale of a product with no substantial non-infringing use, exhaustion must apply unless respondent and petitioners, or Intel and petitioners, expressly agreed that petitioners were purchasing restricted patent rights. Here, it is not contended that respondent and petitioners had such an express agreement between them. In the absence of an express, knowing and voluntary agreement to restrict petitioners' rights under respondent's patents, exhaustion attached with Intel's authorized sale.

The Federal Circuit's contrary conclusion—that Intel, an authorized seller, validly restricted petitioners by issuing a unilateral notice asserting that petitioners had no right to combine the chipsets with non-Intel components—is erroneous. Most obviously, the Federal Circuit's conclusion that a unilateral notice defeats the normal operation of the exhaustion doctrine is inconsistent with the Court's precedents holding that unilateral notices are not sufficient to restrict a purchaser's rights under a

patent that flow from an authorized sale. *See, e.g.*, *Motion Picture Patents Co.*, 243 U.S. at 518-19; *Ill. Tool Works*, 547 U.S. at 38.

In addition, the Federal Circuit ignored that the notice provided to the petitioners was so internally inconsistent and inconsistent with the fundamental purpose of the transaction as to render it unenforceable or hopelessly ambiguous. The sole function of the chipsets, and the sole use for which petitioners purchased them, was to be combined with non-Intel components and made into a computer. To this end, Intel provided detailed specifications describing how the combination should be made. It also provided notice that it was fully authorized to manufacture and sell the chipsets, but informed purchasers that they could not make the infringing combination, while telling them how to do so. In this context, the unilateral notice that the combination was impermissible, if enforced, was both confusing and materially inconsistent with the purpose of the transaction. *See* U.C.C. § 2-702(2) (disallowing supplemental "battle of the forms" terms that materially alter the underlying sales agreement).

E. The Federal Circuit's Decision Undermines The Doctrine Of Contributory Infringement.

Finally, the Federal Circuit's interpretation of exhaustion upsets the delicate balance of patent law by authorizing double recovery for both contributory and direct infringement. The doctrine of contributory infringement grants patentees an avenue of recourse against sellers and others who do not directly infringe the patent "where enforcement against direct infringers is impracticable," such as where the

transaction costs of seeking recovery against the direct infringers (who are generally the product's end-users) are prohibitive. *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 377 U.S. 476, 511 (1964) (internal quotation marks omitted). Exhaustion and contributory infringement are linked, moreover, by virtue of the statutory definition of contributory infringement, which excludes from its scope a sale of "a staple article or commodity of commerce suitable for *substantial noninfringing use*." 35 U.S.C. § 271(c) (emphasis added). Great care must be taken when making pronouncements about exhaustion that would impact contributory infringement liability, because the latter theory of liability is susceptible to abuse, namely windfall double recovery by patentees. Thus, the Court has cautioned that "after a patentee has collected from or on behalf of a direct infringer damages sufficient to put him in the position he would have occupied had there been no infringement, he cannot thereafter collect actual damages from a person liable only for contributing to the same infringement." *Aro Mfg. Co.*, 377 U.S. at 512.

The Federal Circuit's rule, however, creates an imbalance in the patent system that encourages the patentee to exceed its legitimate recovery by first pursuing the contributory infringer and then later pursuing the direct infringer. Here, despite the fact that respondent fully authorized, and was therefore fully compensated for, Intel's contributory infringement, it may still recover against petitioners for direct infringement. That is, the court is allowing respondent a full royalty in return for authorizing Intel's contributory infringement, and then allowing respondent to recover damages from petitioners for a

direct infringement that is nothing more than the inevitable consequences of what would have been, in the absence of the License Agreement, Intel's contributory infringement.

This result can be avoided by a rule that requires a purchaser's express agreement for restrictions on an article transferred in an authorized sale. Where parties act in a commercially reasonable manner, the bargaining process involved to reach express agreements will guarantee that the patentee is not overcompensated.

II. A CONTRARY RULE THAT WOULD ENFORCE NONE OR ALL PURPORTED RESTRICTIONS ON THOSE WHO PURCHASE FROM AUTHORIZED SELLERS WOULD DISRUPT THE PATENT SYSTEM'S CAREFUL BALANCE.

Any alternative rule of exhaustion—that is, one that would require something less than restrictions in a licensing agreement or expressly agreed to restrictions on the purchaser, or one that would prohibit agreements to overcome exhaustion where there is an authorized sale of a patented article with no substantial non-infringing use—would be either overly-permissive or overly-restrictive and impede commerce by disrupting the careful balance of the patent system.

A. Adopting The Federal Circuit's Rule Would Have Significant And Immediate Detrimental Economic Impacts.

At one extreme, adopting the Federal Circuit's ruling would have immediate, detrimental economic impacts. The economic impact of the Federal Circuit's decision in the information technology ("IT")

sector and on the consuming public, indeed, would be great. Modern IT is uniquely characterized by highly integrated products. Manufacturing a single computer, for example, requires the combination of literally thousands of components, manufactured by many different entities, brought together over a complex network of supply and manufacturing chains. Moreover, "[i]n IT . . . one product regularly involves the combination of 50, 100, even 1,000, or . . . 5,000 different patent rights" all of which "must be cleared in order to get the product to market." Mark A. Lemley, *Ten Things to do About Patent Holdup of Standards (And One Not To)*, 48 B.C. L. REV. 149, 151 (2007). And this phenomenon is not limited to the IT realm—chemical, biotechnological, hardware, and software inventions are just as complex and can involve many patents per product. *See* Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 U. TEX. L. REV. 1991, 1992 (2007).

If, as the Federal Circuit held, suspending exhaustion is as easy as requiring licensees to provide mere unilateral notice to purchasers, the rule of exhaustion would be too easily circumvented. A troubling regime, which has already begun to develop, would flourish wherein resourceful patentees will require insertion of restrictive "notices" at every possible point in the manufacturing and distribution channel. If the patentee could extract license fees for a single inventive contribution at every point in the distribution channel, its royalty base would increase dramatically and inappropriately because it would collect multiple royalties for the same infringement, thus destroying the efficiencies and benefits of our modern networked economy. Indeed, the ability to "hold up" product

distribution with unilateral restrictions on a single component could multiply into so many roadblocks that a product could never make it to market. And instead of being limited to the judicially mandated "one bite" of fair compensation, the patentee will now enjoy a smorgasbord of sequentially increasing royalty payments. The result: companies will be subject to increasing royalties at higher levels of integration in the manufacturing chain, and considering the number of patents that apply to complex IT products, the obvious outcome will be increased costs at each stage. Consumers would suffer from the higher cost of, and reduced access to, IT products, while manufacturers down the production chain would have fewer resources available to devote to follow-on innovations.

B. An Alternative Rule Precluding Restrictions On Purchasers Would Over-Expand The Exhaustion Doctrine To The Detriment Of Innovation.

At the other extreme, an alternative test that would require immutable exhaustion would be overly-restrictive and unnecessarily limit the pro-competitive effects of allowing patentees to grant, and purchasers to secure, restricted patent rights through express agreements of varying scope at correspondingly varying valuations.

Such a rule would be contrary to the longstanding principle that a patentee enjoys great freedom, albeit limited by antitrust laws and other legal principles such as the patent misuse doctrine, in granting rights under only portions of its patent right. *See supra* pp. 16-17. If exhaustion becomes immutable, the patentee cannot enjoy its traditional ability to

nonetheless restrict rights under the patent by field, geography or duration. *See, e.g.*, MILGRIM, *supra*, §§ 2.32-2.38 (describing these various restrictions).

The ability of patentees to grant a varying array of rights under the patent at correspondingly varying valuations, moreover, is extremely beneficial to the public. Permitting the patentee, licensee and purchaser to create and enforce restrictions through express agreements ultimately "serve[s] pro-competitive ends by allowing the licensor to exploit its property as efficiently and effectively as possible. These [limitations] can be used to give a licensee an incentive to invest in the commercialization and distribution of products . . . and to develop additional applications for the licensed property." U.S. Dep't of Justice and Federal Trade Comm'n, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY 5 (1995), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,132, at 20,736 (Apr. 6, 1995). Specifically, purchasers have the opportunity to pay a lower price for only those patent rights they need or desire, rather than pay a full royalty for more rights than they require. Because purchasers can negotiate for only those patent rights necessary for their purposes, restricted purchases are economically efficient.

In addition, any immutable exhaustion rule, while seemingly simple to apply, would greatly complicate exhaustion questions. Under IBM's proposed test, patentees, licensees and purchasers that wish to limit exhaustion have a clear path: write clear and express restricted licenses or purchase agreements. In contrast, a rule under which exhaustion cannot be overcome if a patented article has no substantial non-

infringing use would force many exhaustion questions into the courts, because determining whether such uses exist is a difficult and fact-intensive question that is often interpreted differently by patentee and purchaser. *See, e.g.*, *Bandag, Inc. v. Al Bolser's Tire Stores, Inc.*, 750 F.2d 903, 924 (Fed. Cir. 1984) (implied license case demonstrating the complexity of determining the existence of a substantial non-infringing use); *Mentor H/S, Inc. v. Med. Device Alliance, Inc.*, 244 F.3d 1365, 1379 (Fed. Cir. 2001) (same). Indeed, the instant case shows the ambiguity inherent in the phrase "substantial non-infringing use." Here, respondent argued, unsuccessfully, that the chipsets and microprocessors had substantial non-infringing uses, because they could have been used in computers sold "outside the United States," Pet. App. 46a, or "used as replacement parts." Pet. App. 48a. As the district court pointed out, these purported alternative uses are so generic and insubstantial as to "eviscerate the defenses of exhaustion and implied license." Pet. App. 47a. But the arguments demonstrate the potential for disagreement between the patentee and purchaser regarding possible uses for a patented article. *See also Monsanto Co. v. McFarling*, 488 F.3d 973 (Fed. Cir. 2007) (involving protracted litigation over the issue of infringing uses for soybean seeds), *petition for cert. filed*, 76 U.S.L.W. 3081 (No. 07-241, Aug. 22, 2007). Thus, in practice, such a rule would obscure, rather than clarify, the patentee's, licensee's and purchaser's rights under the exhaustion doctrine, forcing exhaustion disputes into the courts.

In short, as in most cases involving the scope and application of patent law, the best rule, and the one

required under this Court's jurisprudence, is a balanced one.

CONCLUSION

For these reasons, the decision of the Federal Circuit should be reversed.

Respectfully submitted,

DAVID J. KAPPOS
MARIAN UNDERWEISER
WILLIAM P. SKLADONY
IBM CORPORATION
One North Castle Drive
Armonk, NY 10504
(914) 765-4343

JOHN D. FLYNN
IBM CORPORATION
11501 Burnet Road
Austin, TX 78758
(512) 838-2753

TRACI L. LOVITT
(*Counsel of Record*)
OGNIAN V. SHENTOV
SARAH E. LIEBER
JONES DAY
222 East 41st Street
New York, NY 10017
(212) 326-3939

MICHAEL A. CARVIN
JONES DAY
51 Louisiana Ave., N.W.
Washington, DC 20001
(202) 879-3939

Counsel for Amicus Curiae

November 12, 2007